WALKER FINANCIAL ADVISORS, INC.
Registered Investment Advisor

Investments – Review, Outlook & Opinion July 2016

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I hope this finds you in good health and enjoying the summer. It's been blue sky and sunshine for the markets lately, with the Brexit related drop a fading memory. Yesterday, the S&P 500 hit a new all-time historic high and the Dow achieved the same feat today closing at 18,348. Quarterly earnings season is upon us and the market clearly is anticipating good results. Will the euphoria be short-lived as we head into the seasonally weak time of year, or will this year be different with the break out to new highs? There's always uncertainty and a reason not to invest, and we are always cautious, but rather than attempt to time short-term moves in stocks, we prefer to take a longer view and hold a balanced mix of high quality securities designed to control downside risk while still generating competitive returns.

Performance Results – Across the client accounts that I manage, including my own, we ended the 2nd quarter higher, with an average net gain of 1.74%, after all fees and costs for the three months. Year-to-date we're up 3.16%, net. Clients with trust accounts that hold tax-exempt municipal bonds will have higher taxable-equivalent returns depending upon their tax bracket. Be sure to check out pages 2 & 3 of your quarterly WFA statement to see your investment gain and portfolio performance.

Portfolio Strategy – Keep it safe and diversified with a mix of individual securities, ETFs, and actively managed funds diversified across different asset classes and industries. Our goal is to preserve and slowly grow your nest egg while focusing just as much on downside risk, as potential return. We are willing to sacrifice some upside in exchange for a more balanced lower risk approach. Having low or no debt is always encouraged at retirement. We also recommend keeping enough money in cash and short duration bond holdings to cover five years' worth of living expenses. Hold a comfortable amount of high quality dividend-paying stocks for appreciation, growing income from dividend increases, and inflation protection. The current low interest rate environment shows few signs of abating, so holding a balanced tax-efficient portfolio makes sense. We customize each client's portfolio to coincide with their age, risk profile, and objectives. Utilities has been a top performing sector this year, so we recently trimmed back and took a profit with a partial sale of **Sempra Energy** common stock following a 21% YTD gain. We will also cut losses on stocks to preserve capital when fundamentals change and the price is heading lower.

<u>Cost Savings</u> – Minimizing your investment costs is important to us, so at a recent meeting with Schwab Advisor Services we requested a fee reduction. I am happy to report that effective immediately the mutual fund transaction fee we pay on buy and sell orders at Schwab will be reduced from $25 to $20.00. Paying this small fee allows us to purchase "institutional class" shares which carry the lowest expense ratio of the various share classes that one mutual fund can offer. For electronic equity trades, the Schwab commission remains at $8.95.

<u>Common Stocks</u> – In a low rate environment, dividend-paying stocks become more valuable so the telecom, utility and REIT sectors have lead the market this year. We have participated with **AT&T, Verizon, Camden Property Trust**, and Sempra. Their respective dividend yields of 4.4%, 4.0%, 3.3%, and 2.6% are competitive, and come with a history of annual dividend increases. Other winners for the quarter included **Bristol Myers Squibb, Intuit, Amazon.com**, and **Virgin America**. Laggards include **Charles Schwab & Co., Microsoft, Stamps.com**, and **Apple, Inc**. Stamps breached support and triggered a recent stop loss sale, and we have reduced our Apple stake based on slowing growth and weak relative performance.

Commercial real estate firm **Jones Lang La Salle, Inc.** has sold off as 15% of company revenue is from the U.K., and the Brexit vote could negatively impact near-term results. Throwing gas on the fire, earlier last week three big asset managers in the U.K. suspended withdrawals from real estate funds. This helped pushed the pound to a 31-year low against the dollar. JLL's U.S. operations are steady and may benefit from safe haven capital flows, so we continue to hold the shares and closely monitor the situation.

We recently bought back into **Alphabet Inc.** This is the new name for the holding company that was previously Google. Google has a new CEO, and is now the largest division of Alphabet. Alphabet has other divisions like GV which provides venture capital funding to bold new companies in the life science, health care, artificial intelligence, robotics, transportation, and agriculture fields. GV was an early investor in Uber.

Your holdings may not include all stocks discussed due to different client inception dates and manager discretion.

<u>U.S. Equity ETF's</u> – We are long-term holders of three core ETF's for exposure to different areas of the U.S. stock market. The most conservative large company holding is the **SPDR S&P Dividend ETF**. This one has been on fire and is up 15% this year, so we are deferring any additional purchases at this time. For small company stocks, we prefer the **Wisdomtree Smallcap Dividend Fund**; and for large company growth stocks, the **Powershares QQQ Trust** is tough to beat. Remember that exchange-traded funds typically come with greater tax-efficiency, all-day tradability, and generally lower expenses.

For targeted industry exposure, we established new positions in three **Select Sector SPDR Funds** at favorable price points. These SPDR's are industry specific slices of the S&P 500 in the industrial, materials, and energy sectors.

<u>International Equity Funds</u> – We dodged a bullet by selling all but one of our international stock funds last year. The only fund we currently own with significant overseas exposure is **Grandeur Peak Global Reach**, which owns a broad based portfolio of small and mid-size companies from both North America, Europe, and Asia. This is a relatively small position that we have maintained due to favorable valuations and the excellent long-term record of lead manager Robert Gardiner.

Negative Interest Rates – It started in 2014 when several of Europe's central banks cut key interest rates below zero in an effort to get banks to lend money instead of parking it at the central bank. Now Sweden, Switzerland, Denmark, and Japan have followed suit. An insatiable desire for safety and income has catapulted high quality bond prices to record highs, and yields to record lows. History was made last week when the U.S. 10-year Treasury yield closed at an all-time record low yield of 1.36%. This is still a lush yield compared to negative bond yields in Germany at -0.08%, and Japan at -0.28%. The Fed has stated they do not want negative interest rates in the U.S., but foreign capital flows continue to favor the dollar and demand for AAA-rated U.S. Treasury securities has never been stronger. This action has provided a big tail wind for all types of bonds and inflated year-to-date returns for higher quality fixed income holdings.

Best Income Investments – Interest and dividends are a big part of our total return strategy and with bond yields reaching record lows we are finding very little value in any new individual bond offerings. Please remember that it's dangerous to look in the rear view mirror when investing in bond funds and that past performance most certainly will not be an indication of future returns. Our goal is to reap the dividends, while the share price stays within a normal range. High quality Treasury and corporate bonds are extended in price, so we prefer a couple of actively managed bond funds that pay monthly dividends for new money. The **Vanguard High Yield Corporate** is a higher quality fund for its asset class and has a current yield of 5.3%. The **T. Rowe Price Institutional Floating Rate** holds senior secured bank loans and pays 4.3%.

Preferred stocks are designed to provide higher yields than common stocks or bonds, and are often issued to facilitate a corporate merger. Banks have historically been large issuers due to favorable tax and regulatory features. We own the **iShares U.S. Preferred Stock ETF**, which pays a monthly dividend and sports a current yield of 5.3%. We own a small position in one closed-end bond fund for high octane performance, the **Pimco Dynamic Income Fund**. This one is not for the faint of heart due to portfolio leverage that amps up the volatility and the yield. The second quarter total return was 7.6%, with a current dividend yield of 9.6%.

In Conclusion – Your returns will vary depending upon your entry date, risk tolerance, personal objectives, and asset allocation. Warren Isenberg and I work as your personal financial advisors to preserve and grow "our" capital. We both own many of the same securities found in our client accounts. Our goal is to preserve and build your wealth. We thank you for your trust and confidence.